REPORT OF EXAMINATION
OF THE

CALIFORNIA EARTHQUAKE AUTHORITY

AS OF
DECEMBER 31, 2004

Filed May 15, 2006

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San Francisco, California
January 16, 2006

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA EARTHQUAKE AUTHORITY

(hereinafter also referred to as the CEA or the Authority) at the primary location of its books and records, 801 K Street, Sacramento, California 95814.

SCOPE OF EXAMINATION

The previous examination of the CEA was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2004. The examination included a review of the CEA's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the CEA's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; business in force by states; loss experience; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

In August 2005, the CEA's governing board approved a rate cut averaging 22.1 percent for the CEA's base-limits program. The CEA has stated that 85 percent of its policyholders statewide will see rate decreases while rates for mobilehomes and condominium loss assessment coverage will not change unless and until further study by the CEA indicates a rate change is needed.

In addition to the rate cut, the governing board also approved two additional filings that support two new product enhancements. The first of these product enhancements will allow policyholders to "un-bundle" the existing CEA supplemental-coverage packages and instead, select individual limits for each coverage. The other new product enhancement will allow policyholders to buy an additional $10,000 of Building Code Upgrade coverage, for a total of $20,000 in that coverage.

In 2005, the CEA's governing board approved the issuance of $300 million in pre-event revenue bonds to supplement the CEA's resources for paying earthquake claims for the 2006 calendar year. The revenue bonds are risk financing instruments that are backed by the pledge of future CEA revenues. Proceeds from the revenue bond sale would be placed in a separate Claims Paying Account to be used exclusively for the payment of policyholder claims and, until then, invested per the CEA's investment policy for claims-paying resources. The proceeds will be split between the CEA base coverage ($250 million) and the supplemental coverage ($50 million). The revenue bonds would be secured by a first claim only on the premiums received from base coverage and supplemental coverage and interest and other earnings on investments in the Claims Paying Account. The revenue bonds could be issued on a tax-exempt or taxable basis in either a fixed or floating interest rate format. The bonds could have a stated maturity of between 10 and 20 years; however, the bonds could be purchased or redeemed prior to the maturity date.

CEA HISTORY

The CEA was created in 1996 pursuant to California Insurance Code (CIC) Section 10089.6 to transact insurance in California as necessary to sell policies of basic residential earthquake insurance in the manner set forth in CIC Sections 10089.26 through 10089.28, and commenced operations in December 1996.

CIC Section 10089.21 designates the CEA as a public instrumentality of the State of California and the exercise of its powers as an essential state government function. This section also states that the CEA is not, and shall never be, authorized to become a debtor in a case under the United States Bankruptcy Code, or to make an assignment for the benefit of creditors, or to become the subject of any similar case or proceeding, nor is the CEA subject to Article 14 (commencing with Section 1010) or the CIC and Article 14.2 (commencing with Section 1064.1). In addition, the Section provides that the Commissioner shall not, directly or indirectly, impede or in any manner interfere with, but shall affirmatively take all necessary steps to effect: (a) the full and timely payment of principal, interest and premiums on revenue bonds of the CEA, and amounts due those bond insurers and providers of credit support and letters of credit; (b) any pledge or assignment of revenues as security for those payments or amounts due, and the full and timely application of those pledged or assigned revenues to those payments and amounts due.

MANAGEMENT AND CONTROL

Pursuant to California Insurance Code (CIC) Section 10089.7(a), the CEA is governed by a three-member governing board consisting of the Governor, the State Treasurer, and the Insurance Commissioner, each of whom may name designees to serve as board members in their place. The Speaker of the Assembly and the Chairperson of the Senate Rules Committee serve as nonvoting, ex officio members of the governing board, and may name designees to serve in their place.

CIC Section 10089.7(c) provides that the governing board shall have the power to conduct the affairs of the CEA, and may perform all acts necessary or convenient in the exercise of that power.

A listing of the members of the governing board and principal officers serving on December 31, 2004 follows:

Directors

Name	Principal Business Affiliation
Arnold Schwarzenegger	Governor, State of California
Philip Angelides	State Treasurer, State of California
John Garamendi	Insurance Commissioner, State of California
Fabian Nunez*	Speaker of the Assembly, State of California
Don Perata*	Chairman of the Senate Rules Committee State of California

**Non-voting members*.

Principal Officers

Name	Title
Elaine Bush	Chief Executive Officer
Timothy Richison	Chief Financial Officer
Bob Stewart	Operations Manager

Management Agreements

Services are performed on behalf of the CEA by the participating insurers pursuant to the terms of the Participating Insurer Agreements signed by the CEA and each participating insurer. These services include policy administration and claims settlement.

CLAIMS PAYING CAPACITY

As of December 31, 2004, the CEA's claims paying capacity for basic earthquake coverages was $6.9 billion. The CEA's claims paying capacity comes from CEA's available capital ($1.8 billion), post-earthquake industry assessments under California Insurance Code Sections 10089.23 and 10089.30 ($3.6 billion), and reinsurance coverage ($1.5 billion).

The CEA's claims paying capacity for basic earthquake coverages beginning in January 2006 is projected by the CEA to be $7.7 billion. The projected increase is expected to come from a $291 million increase in CEA capital, $282 million in additional reinsurance coverage and $250 million through the issuance of revenue bonds.

Historically, the claims paying capacity for the supplemental earthquake coverages was supported solely by a 100% quota share reinsurance contract. At December 31, 2004, the CEA's claims paying capacity for the supplemental earthquake coverages was $350 million, provided by a 100% quota share reinsurance contract. For 2006, the claims paying capacity for the supplemental earthquake coverages was increased to $596 million, through a 100% quota share reinsurance contract ($450 million) and an excess of loss reinsurance contract ($146 million excess of $450 million).

The CEA stated that for 2007, the financing of the supplemental earthquake coverages will be primarily through an excess of loss reinsurance contract. The claims paying capacity for the supplemental earthquake coverages in 2007 is projected to be $665.3 million. The claim paying capacity is expected to come from the CEA's supplemental capital ($300,000), the issuance of revenue bonds in 2006 ($50 million), and an excess of loss reinsurance contract ($615 million excess of $50 million).

TERRITORY AND PLAN OF OPERATION

Pursuant to California Insurance Code (CIC) Section 10089.6(a), the CEA is only authorized to write basic residential earthquake insurance in the State of California. Earthquake insurance policies are available for residential property owners, condominium owners, mobile homeowners, and renters in California.

The CEA offers two types of earthquake insurance coverage: primary coverage and supplemental coverage. The primary coverage (or "mini-policy") is the CEA's main product and has been available since the CEA began operations in 1996. It includes coverage on the dwelling building (dwelling coverage limits matches the dwelling coverage limits on the underlying homeowner's or mobile homeowner's policy) with a 15% deductible (no coverage on appurtenant structures), a $5,000 coverage limit on contents (the 15% dwelling loss triggers this benefit) and a $1,500 coverage limit on loss of use (with no deductible). The renter policy has a $5,000 coverage limit on contents with 15% deductible and a $1,500 coverage limit on loss of use with no deductible. The condominium policy has a $25,000 coverage limit on property with a 15% deductible, a $5,000 coverage limit on contents with 15% deductible and a $1,500 coverage limit on loss of use with no deductible. In each case the policy covers primary damage from the earthquake itself but excludes any benefits for damage from fire caused by the earthquake.
The supplemental options available to homeowners and mobile home owners are lower deductibles on dwelling coverage (reduced to 10%), higher limits on contents (up to $100,000), and on loss of use (up to $15,000).

CEA's earthquake business is placed through its participating insurers. Pursuant to CIC Section 10089.9, each insurer participating in the CEA shall execute a contract with the Commissioner that sets forth its rights and responsibilities as a CEA participant, and such contract shall be part of the CEA's plan of operations and shall be uniform for every participating insurer. Insurers writing in the CEA represent more than 70 percent of the homeowners' insurance market in California. As of the examination date, there were 19 insurers participating in the CEA with 17 actively writing business. Participating insurers receive a 10 percent commission on all business placed. The CEA imposes an eligibility requirement for policies issued under these agreements.

During the examination, it was noted that the CEA did not have available fully executed insurer participation contracts as required by CIC Section 10089.9 for two of its participating insurers. The

CEA stated that contracts have been executed by both participating insurers, had been received and executed by the CEA and were awaiting review and signature by the Commissioner.

The following table shows the direct premiums written during the examination period:

Year	Written Premiums
2004	$465,467,061
2003	436,801,794
2002	434,513,962
2001	424,185,211

Under CIC Section 10089.6 (c), the CEA's operating expenses cannot exceed 3 percent of the premium income received.

Credit Facilities

CIC Section 10089.50 states that the State Treasurer may from time to time enter into one or more credit facilities permitting the CEA to draw an amount up to $1 billion with payment, interest rate, indemnity, compensation, security, default, remedy, and other terms and conditions as determined by the CEA. All drawings of these credit facilities shall be available as funding for the CEA as provided in CIC Section 10089.29. Pursuant to CIC Section 10089.51, the CEA shall have the power to pledge to the providers of credit facilities, and to the owners of bonds, the surcharges imposed or to be imposed pursuant to CIC Section 10089.29(b) to secure payment of all obligations of the CEA under those credit facilities and bonds. CIC Section 10089.23(a) (3) states in part that the maximum permissible bond issuances or other debt financing issued, or secured by, the Treasurer pursuant to CIC Section 10089.29 shall be reduced uniformly by the multiplication of the maximum assessments and other amounts provided in this section by the percentage of the total residential property insurance market share participation attained by the CEA upon its commencement. This credit facility was not in use as of December 31, 2004.

Revenue Bonds or Other Debt Financing

CIC Section 10089.29 states that if benefits paid by the CEA following any earthquake event exhaust the total of (1) the CEA's available capital, (2) the maximum amount of all insurer capital contributions and assessments pursuant to CIC Sections 10089.15 and 10089.23, (3) all reinsurance actually available under contract to the CEA, and (4) all capital committed and actually available by contract to the CEA from private capital markets, the State Treasurer, as agent for sale of bonds for the CEA, may sell investment grade revenue bonds, or issue or secure other debt financing in an amount up to $1 billion, as determined by the board. The State Treasurer shall make available the net proceeds of the revenue bonds or debt financing as funding for the CEA. The State Treasurer may sell revenue bonds for the purpose of refunding the revenue bonds or other debt financing when authorized to do so by the board, and the surcharge authorized by this Section may be used to repay the refunding.

In the event of a revenue bond sale or debt financing arrangement pursuant to CIC Section 10089.29, the CEA shall have the power annually to surcharge all CEA policies to secure funds solely to repay the bonded indebtedness or other debt. The net surcharge may in no event exceed $1 billion, plus costs of issuance and sale of those revenue bonds or other debt and amounts paid or payable to bond issuers and providers of credit support and letters of credit for and interest on those revenue bonds and other debt. In no event shall the surcharge on any CEA policy exceed 20 percent of the annual basic residential earthquake insurance premium in any one year for the policy.

CIC Section 10089.29(d) states that the CEA shall cancel the policy of basic residential earthquake insurance if the policyholder fails to pay the earthquake policy surcharge authorized by the CEA, and the insurer shall cancel the policy of residential property insurance if the policyholder fails to pay the policy surcharge authorized by the CEA.

Post Earthquake Industry Assessments

CIC Section 10089.23 provides that if at any time following the payment of earthquake losses, the CEA's available capital is reduced to less than $350 million, or if at any time the CEA's available capital is insufficient to pay benefits and continue operations, the CEA shall have the power to assess participating insurance companies. The assessment shall be limited to the amount necessary to pay the outstanding and expected claims of the CEA and to return the CEA's available capital to $350 million, as determined by the governing board, subject to approval by the Commissioner. Each participating insurer's assessment shall be determined by multiplying its residential earthquake insurance market share as of April 30th of the immediately preceding year, or the most recent year for which premium data not more than one year old is available, by the amount of the total assessment sought by the CEA. The total of all assessments levied by the CEA pursuant to this Section shall not exceed $3 billion, regardless of the frequency or severity of earthquake losses at any and all times subsequent to the creation of the CEA. Once a participating insurer has paid amounts equal to its residential insurance market share multiplied by $3 billion, the CEA's power to assess that insurer under this Section shall cease, and the CEA shall be prohibited from levying additional assessments on that insurer pursuant to this Section. The participating insurer assessments under this Section will expire in December 2008. CIC Section 10089.30 provides that if benefits paid by the CEA due to earthquake events exhaust the total of (a) the CEA's available capital; (b) the maximum amount of all insurer contributions and assessments pursuant to CIC Sections 10089.15 and 10089.23; (c) all reinsurance actually available and under contract to the CEA; (d) the maximum amount of all policyholder assessments pursuant to CIC Section 10089.29; and (e) all capital committed and actually available from the private capital markets, the governing board, subject to the approval of the Commissioner, shall have the power to assess participating insurance companies. The total amount of all assessments levied against participating insurance companies by the CEA pursuant to this Section, shall not exceed $2 billion, regardless of the frequency or severity of earthquake losses at any and all times subsequent to the creation of the CEA. Once a participating insurer has paid amounts equal to its residential earthquake insurance market share multiplied by $2 billion, pursuant to this Section, the CEA's power to assess that insurer under this Section shall cease and the CEA shall be prohibited from levying additional assessments on that insurer pursuant to this Section. The governing board shall make the assessment pursuant to this Section in proportion to each participating insurer's residential earthquake market share. The assessment shall be limited to the amount necessary to pay the expected claims of the CEA and return the CEA's available capital to $350 million, as determined by the governing board, subject to the approval by the Commissioner.

CIC Section 10089.33 states that if the average daily balance of the CEA's available capital exceeds $6 billion, for the last 180 days of any calendar year, the governing board shall relieve all participating insurers of their obligation to pay additional earthquake assessment under this chapter by an amount equal to the amount of available capital in excess of $6 billion. Each December 31st thereafter, the governing board shall further reduce the aggregate assessment authorized by this Section by the net increase in available capital in excess of the previous level of available capital at which the reduction in the aggregate assessment was made. No reduction pursuant to this subdivision shall exceed 15 percent of the original aggregate assessment in any year of operation of the CEA. In no event shall any reduction previously authorized by the governing board be reinstated.

Claims in Excess of Available Capital

CIC Section 10089.35 states that if at any time the governing board determines that all of the CEA's available capital may be exhausted and no source of additional funds such as assessments, reinsurance or private capital market moneys will be available to the CEA to pay policyholder claims, the governing board shall draw up and present to the Commissioner a plan to pay policyholder claims on a pro rata basis or in installment payments. The governing board shall maintain sufficient capital to ensure the continued operations of the CEA for the purpose of implementing the proration or installment plan. At this point, the Commissioner shall adopt a schedule for restitution of an insurer's statutory obligation to offer earthquake insurance by a means other than the placement in the CEA. In no event shall the schedule adopted pursuant to this subdivision be for a period longer than six months.

California Insurance Guarantee Association Coverage and Assessments

CIC Section 10089.34 provides that policies issued by the CEA shall not be subject to assessment for, nor shall any CEA policyholder be eligible for benefits from the California Insurance Guarantee Association.

Earthquake Loss Mitigation Fund

CIC Section 10089.37 states that the governing board shall set aside in each calendar year an amount equal to 5 percent of investment income accruing to the CEA's invested funds, or $5 million, whichever is less, if deemed actuarially sound by a consulting actuary employed for, or hired by the CEA, to be maintained as a sub-account in the California Earthquake CEA Fund. The CEA shall use those funds to fund the establishment and operation of an Earthquake Loss Mitigation Fund. CIC Section 10089.38 states that the Earthquake Loss Mitigation Fund may be applied by supply grants or loan guarantees to dwelling owners who wish to retrofit their homes to protect against earthquake losses.

It was noted that during 2003 and 2004 no amounts were set aside for the Earthquake Loss Mitigation Fund. It is recommended that the amounts required under CIC Section 10089.37 be set aside in each calendar year.

Cessation of Writing

CIC Section 10089.54 states that unless authorized by a statute enacted subsequent to the effective date of this section, the CEA shall cease writing new earthquake insurance policies 180 days after implementation by both the Federal National Mortgage Association and the Federal Home Loan Mortgage Association of policies to require earthquake insurance for any single-family residential structure other than a condominium unit of town home as a condition of purchasing as mortgage or trust deed secured by that structure. It is the intent of the Legislature that in that event it should convene to consider whether the CEA should continue to write new earthquake insurance policies, with or without modification, or to cease writing new earthquake insurance policies.

GROWTH OF CEA

The CEA reported operating and net income in each year of the examination period as follows:

Year	Net Operating Gain	Net Income
2001	$131,025,293	$168,635,111
2002	193,994,328	216,033,628
2003	208,127,373	234,828,387
2004	182,445,455	220,576,508

REINSURANCE

Assumed

The CEA has no reinsurance assumed.

Ceded

The following table is a summary of the CEA's ceded reinsurance program as of the examination date:

Type of Contract	Line of Business Covered	CEA's Retention	Reinsurer's Limit
1st Aggregate Excess Layer	Basic Earthquake Policies	$2.9 billion aggregate incurred ultimate net loss (1)	$700 million aggregate incurred ultimate net loss excess of $2.9 billion
1st Transformer Layer	Basic Earthquake Policies	$3.6 billion aggregate incurred ultimate net loss	$150 million aggregate incurred ultimate net loss excess of $3.6 billion
2nd Aggregate Excess Layer	Basic Earthquake Policies	$3.75 billion aggregate incurred ultimate net loss	$150 million aggregate incurred ultimate net loss excess of $3.75 billion
2nd Transformer Layer	Basic Earthquake Policies	$4.617 billion aggregate incurred ultimate net loss (1)	$200 million aggregate incurred ultimate net loss excess of $4.617 billion
3rd Aggregate Excess Layer	Basic Earthquake Policies	$4.817 billion aggregate incurred ultimate net loss	$300 million aggregate incurred ultimate net loss excess of $4.817 billion
Supplemental Policy Quota Share	Supplemental Earthquake Policies	None	100% of gross liability

(1) - The industry assessment capacity provided by California Insurance Code Section 10089.23 and the available capital of the CEA ($1.8 billion at December 31, 2004) provide the claims paying capacity up to the CEA retention under the 1st Aggregate Excess Layer ($2.9 billion). In addition, the industry assessment capacity provided by California Insurance Code Section 10089.23 provides claims paying capacity between the end of the 2nd Aggregate Excess Layer ($3.9 billion) and the CEA'S retention under the 2nd Transformer Layer ($4.617 billion).

Multiple Layer Catastrophe Excess of Loss: Effective January 1, 2004, the CEA entered into a multiple layer catastrophe excess of loss treaty covering the excess liability accruing to the CEA under its policies classified as base-limits earthquake insurance as respects those lines of business classified by the CEA as homeowners, mobile homeowners, condominium owners, and renters/tenants. This contract is effective from January 1, 2004 through December 31, 2004. The multiple layer catastrophe excess of loss treaty is divided into three aggregate layers of coverage. Under the first aggregate layer, the CEA retains and is liable for an aggregate incurred ultimate net loss of $2.9 billion and the reinsurer is liable for the amount of $700 million of aggregate incurred ultimate net loss in excess of $2.9 billion. Under the second aggregate layer, the CEA retains and is liable for an aggregate incurred ultimate net loss of $3.75 billion and the reinsurer is liable for the amount of $150 million of aggregate incurred ultimate net loss in excess of $3.75 billion. Under the third aggregate layer, the CEA retains and is liable for an aggregate incurred ultimate net loss of

$4.817 billion and the reinsurer is liable for the amount of $300 million of aggregate incurred ultimate net loss in excess of $4.817 billion.

This contract provides that whenever losses sustained by the CEA appear likely to result in a claim, the CEA shall provide the reinsurer with sufficient information to substantiate that this contract is likely to incur loss, and the CEA will then establish an interest bearing escrow account for the payment of losses. The CEA can request payment twice per month for losses anticipated over each two-week period.

Transformer Reinsurance: Effective January 1, 2004, the CEA entered into a transformer reinsurance contract covering the excess liability accruing to the CEA under its policies classified as base-limits earthquake insurance as respects those lines of business classified by the CEA as homeowners, mobile homeowners, condominium owners, and renters/tenants. This contract is effective from January 1, 2004 through December 31, 2005. Under the First Transformer Layer of this contract, the CEA retains and is liable for aggregate incurred ultimate net loss of $3.6 billion and the reinsurer is liable for the amount by which the CEA's aggregate incurred ultimate net loss exceeds $3.6 billion, but the maximum aggregate liability of the reinsurer under the First Transformer Layer is not to exceed $150 million. Under the Second Transformer Layer of this contract, the CEA retains and is liable for aggregate incurred ultimate net loss of $4.617 billion and the reinsurance is liable for the amount by which the CEA's aggregate incurred ultimate net loss exceeds $4.617 billion, but the maximum aggregate liability of the reinsurer under the Second Transformer Layer is not to exceed $200 million.

The CEA has not made any recoveries of losses from either of its Multiple Layer Catastrophe Excess of Loss reinsurance contract or Transformer Reinsurance contract to date.

Supplemental Policy Quota Share: Effective March 1, 2001, the CEA entered into a quota share reinsurance agreement covering earthquake insurance classified by the CEA as supplemental earthquake insurance as respects those lines of business classified by the CEA as homeowners, mobile homeowners, condominium owners, and renters/tenants. The term of this agreement is from March 1, 2001 through June 30, 2004, but can continue in force thereafter until terminated by either party under 180 days prior written notice. This contract was still in force as of December 31, 2004. Under this contract, the CEA shall cede to the reinsurer and the reinsurer agrees to accept 100 percent of the CEA's gross liability.

Virtually all of the reinsured losses that were incurred during the examination period were made under the Supplemental Policy Quota Share contract.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders from January 1, 2001 through December 31, 2004

Statement of Financial Condition
as of December 31, 2004

	Ledger and Non-ledger Assets	Non-Admitted Assets	Net Admitted Assets	Notes
Assets				
Bonds	$1,076,103,114	$	$1,076,103,114	
Cash and short-term investments	937,410,578		937,410,578	
Investment income due and accrued	12,277,578		12,277,587	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	32,421,898	2,834,131	29,587,767	
Electronic data processing equipment	97,316		97,316	
Furniture and equipment	16,255	16,255	-	
Other assets nonadmitted	2,531	2,531	-	
Aggregate write-ins for other than invested assets	116,069	106,739	9,330	
Total assets	$2,058,445,339	$ 2,959,656	$2,055,485,683	
Liabilities, Surplus and Other Funds				
Losses			$ 426,848	(1)
Loss adjustment expenses			38,029	(1)
Other expenses			1,387,161	
Unearned premiums			213,426,750	(2)
Ceded reinsurance premiums payable			7,287,143	
Funds held by company under reinsurance treaties			76,658	
Remittances and items not allocated			3,613,344	
Provision for reinsurance			8,412,000	
Total liabilities			234,667,933	
Aggregate write-ins for special surplus funds		$ (8,946,656)		
Gross paid-in and contributed capital		700,037,942		
Unassigned funds		1,129,726,464		
Surplus as regards policyholders			1,820,817,750	
Total liabilities, surplus and other funds			$2,055,485,683	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income		
Premiums earned		$259,646,767
Deductions:		
Losses incurred	$ (2,442,866)	
Loss expenses incurred	(203,071)	
Other underwriting expenses incurred	79,847,249	
Total underwriting deductions		77,201,312
Net underwriting gain		182,445,455
Investment Income		
Net investment income earned	$34,299,117	
Net investment gain		34,299,117
Other Income		
Net loss from agents' or premium balances charged off	$ (1,541,752)	
Finance and service charges not included in premiums	374,619	
Supplemental commissions	4,999,069	
Total other income		3,831,936
Net income		$220,576,508

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		$1,562,306,918
Net income	$220,576,508	
Change in nonadmitted assets	(373,276)	
Change in provision for reinsurance	36,947,000	
Change in over 90 days unearned installments	(222,550)	
Prior period adjustments	3,260	
Net gain from agents balances	1,579,890	
Change in surplus as regards policyholders for the year		258,510,832
Surplus as regards policyholders, December 31, 2004		$1,820,817,750

Reconciliation of Surplus as Regards Policyholders
from December 31, 2000 through December 31, 2004

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2000, per Examination			$948,150,930
Net income	$840,073,634	$	
Change in nonadmitted assets		69,493	
Change in provision for reinsurance	28,331,877		
Cumulative effect of change in accounting principles	1,569,233		
Change in paid-in capital	9,929,281		
Aggregate write-ins for losses in surplus		7,167,712	
Totals	$879,904,025	$7,237,205	
Net increase in surplus as regards policyholders			872,666,820
Surplus as regards policyholders, December 31, 2004, per Examination			$1,820,817,750

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The only line of business written by the CEA is Earthquake, which has a fast reporting and payment development period. Net paid losses and loss adjustment expenses since the CEA's inception were approximately $3.5 million, and loss and loss adjustment expense reserves reported by the CEA at December 31, 2004 were less than $500,000. A review was made of the cash disbursements and subsequent reporting of claims during the first six months of 2005, and no change has been made by the examination in the loss or loss adjustment expense reserves as of December 31, 2004.

Under the participating insurer agreements, the participating insurer is paid 9 percent of the net amount of the claim as reimbursement for the participating insurer's claim expenses associated with servicing the CEA's earthquake claims. Consequently, loss adjustment expense reserves are set at 9 percent of the unpaid loss reserves.

(2) Unearned Premiums

At December 31, 2004, the CEA reported its liability for unearned premiums net of reinsurance ceded credit of approximately $16.9 million. The ceded credit taken relate to the supplemental policy quota share contract.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Territory and Plan of Operations – Earthquake Loss Mitigation Fund (Page 11): It is recommended that the amounts required under CIC Section 10089.37 be set aside in each calendar year.

Previous Report of Examination

Accounts and Records (Page 17): It was recommended that the CEA file its statements with the Insurance Commissioner on a Statutory Accounting Principles (SAP) basis as required for insurers under CIC Section 923. The CEA now files the Statutory Accounting statements as was recommended.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the CEA's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Ber Vang, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California